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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re	Case No. 05-91185-A-13G
BAXTER and TAMARA GILTON,	Docket Control No. CBC-1
Debtors.	Date: December 12, 2005 Time: 2:00 p.m.

MEMORANDUM DECISION

The motion before the court asks for both relief from the automatic stay and dismissal. The movants, however, voluntarily dismissed the request for relief from the automatic stay at the first hearing on the motion. The remainder of the motion argues the petition was not filed in good faith and therefore should be dismissed. The motion to dismiss the petition will be denied for the reasons discussed below.

Prior to the filing of this case, the debtors, Baxter and Tamara Gilton, and the movants, Armelin and Maria deSousa, allegedly entered into a contract obligating the debtors to sell real property to the movants. The movants assert that the debtors breached this agreement, both by contracting to sell it to another person, Wendel Trinkler, and by refusing to consummate the sale. The movants commenced an action in state court approximately one year ago to compel the debtors to sell the

property to the movant. In the course of that litigation, the debtors threatened to file bankruptcy if the movants did not settle the state court action on terms acceptable to the debtors.

When there was no settlement, the debtors filed this case on June 10, 2005. The movants were listed on Schedule F (general unsecured claims) and on Schedule G (executory contracts and unexpired leases). The chapter 13 trustee served the proposed plan together with the Notice of Commencement of Case, etc., and a proof of claim form. The trustee's proof of service reveals that the movants were served with these documents on July 5, 2005.

The Notice of Commencement of Case informed all parties in interest, including the movants, that objections to the plan had to be filed and served no later than the 14 days following the first meeting. The plan itself contained the same notice. The first meeting was concluded on July 27, 2005.[1]

Thus, assuming the movants and counsel were not earlier told informally of the filing of the petition, the movants were served on July 5 with a combined notice that the case had been filed, the date of the first meeting, and the deadline for objecting to the plan. They do not dispute receipt of that notice.

Because the first meeting concluded on July 27, objections to confirmation of the plan had to be filed and served no later than August 10. Consequently, the movants and counsel had 36

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[1] The trustee's report of the first meeting reveals that an attorney for the other party, Wendel Trinkler, claiming to have an executory contract for the purchase of the subject property attended the first meeting.

days of notice of the deadline for objecting to the plan, well in excess of the 25 days of notice mandated by Fed. R. Bankr. P. 2002(b).

The plan, as permitted by 11 U.S.C. § 1322(b)(7), provided for rejection of the executory contract between the debtors and the movants (as well as the contract with Mr. Trinkler) for the purchase of the subject property.[2] No objection to confirmation of the plan and the rejection of the executory contracts were raised. Consequently, on September 26, 2005, the plan was confirmed. No appeal was taken from the confirmation order and no attempt has been made to vacate the confirmation order on the ground that it was procured by fraud. See 11 U.S.C. § 1330.

This motion argues that the petition was filed in bad faith and should be dismissed. The factual underpinnings of the motion arose before the plan was confirmed. Indeed, the relevant facts end with the filing of the petition and the proposing of a plan that rejected the executory contract with the movants.

Specifically, the movants assert that the petition should be dismissed because its purpose is to unnecessarily reject the executory contract for the sale and purchase of the subject property to the movants. The movants view this rejection as unnecessary because the property is encumbered by only $116,163 in debt. Performing the contract with the movants would allegedly give the debtors the funds to pay these claims as well as all unsecured claims. The movants fear that allowing the

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[2] The court comes to no conclusion whether these contracts are actually executory.

rejection of their contract and permitting the case to proceed will leave the movants with nothing and the debtors with the $528,120 equity in the property.

The first response to this assertion is that the debtors will not be left with $528,120 in equity. The property has a scheduled value of $800,000. In addition to the $116,163 in secured debt, the schedules also list $155,717 in unsecured debt [which is classified in Class 7 of the confirmed plan] that must be paid in full and with interest. Also, the movants and Mr. Trinkler have the right to file proofs of claim for any damages caused by the rejection of their contracts. See 11 U.S.C. § 502(g). Assuming their claims are allowed, their claims would also be in Class 7. Like the other $155,717 in unsecured claims, the claims arising from the rejection will be paid in full and with interest.

In order to service the secured debt encumbering the property, to pay the Class 7 claims in full, and to pay the rejection claims, if any, in full and with interest, the confirmed plan requires the debtors to sell subject property.

In short, the debtors are not simply rejecting the executory contracts and then walking out of bankruptcy court with the property or its net value. The property will be sold and the proceeds used to pay the secured debt and all unsecured debts, including any debts owed to the movant and to Mr. Trinkler that are occasioned by the rejection of their contracts.[3]

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[3] Because no deadline has been set for filing claims by those persons, such as movants and Mr. Trinkler, whose executory contracts and unexpired leases with the debtor have been

The second response to the dismissal motion is that it comes too late. While the motion attempts to draw a distinction between a motion seeking dismissal because the petition, as distinguished from the chapter 13 plan, was filed in bad faith, this distinction, in the context of the facts of this case, is irrelevant.

The important distinction is whether the basis for dismissal arose prior to the confirmation of the plan. See Duplessis v. Valenti (In re Valenti), 310 B.R. 138, 151 (B.A.P. 9th Cir. 2004). Only when a debtor has concealed facts that prevent a creditor from seeking dismissal of the case prior to confirmation may a creditor seek dismissal based on preconfirmation conduct. In Valenti the Bankruptcy Appellate Panel held that "res judicata will not necessarily defeat a future motion to convert or dismiss . . . under Section 1307(c) based on preconfirmation matters, where the debtor's own conduct (such as concealment) would amount to estoppel to bar that defense." Id.

When a debtor is not eligible for chapter 13 relief under 11 U.S.C. § 109(e) [which sets debt limits for chapter 13 debtors], or is misusing the bankruptcy process, creditors must immediately seek dismissal. The court will not confirm plans in such cases. But, if a creditor, despite notice of the bankruptcy case and

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rejected, the court will set a deadline. See Fed. R. Bankr. P. 3002(c)(4). In the court's ruling appended to the minutes of the hearing, it set January 12, 2006 as the deadline for rejection claims. On further reflection, the court concludes that this would not be sufficient notice. Parties in interest with such claims shall file them on or before March 13, 2006. The debtors are to give notice of this deadline to all persons who are parties to rejected unexpired leases or executory contracts.

knowledge of the relevant facts warranting dismissal, waits until after a plan has been confirmed to seek dismissal, they have waited too long.

Eisen v. Curry (In re Eisen), 14 F.3d 469 (9th Cir. 1994), is instructive. In Eisen, a debtor entered into a contract to sell real property to a third party. The debtor reneged and the third party filed a state court action for specific performance. On the eve of trial, the debtor filed his first chapter 13 petition. In that bankruptcy case, the debtor falsely claimed he had no interest in the property and he attempted to reject his contract with the third party. The bankruptcy court concluded the plan had been proposed in bad faith and dismissed the petition. Less than two months later, after the state court action had been reset for trial, the debtor filed another chapter 13 petition and again attempted to reject the contract. The bankruptcy court found that the petition had been filed in bad faith and dismissed it. In affirming the dismissal of the second case, the Ninth Circuit held:

> A Chapter 13 petition filed in bad faith may be dismissed 'for cause' pursuant to 11 U.S.C. § 1307(c). In re Powers, 135 B.R. 980, 991 (Bankr. C.D. Cal.1991); In re Love, 957 F.2d 1350, 1354 (7th Cir. 1992); In re Gier, 986 F.2d 1326, 1329 (10th Cir. 1993). **To determine if a petition has been filed in bad faith courts are guided by the standards used to evaluate whether a plan has been proposed in bad faith.** 11 U.S.C. § 1325(a)(3); Powers, 135 B.R. at 994; Gier, 986 F.2d at 1329.

See Eisen, 14 F.3d at 470 [emphasis added].

This court does not cite Eisen for the proposition that a motion to dismiss a chapter 13 petition must be prosecuted before a plan is confirmed. The opinion in Eisen is silent on this

issue. The decision in Valenti disposes of that issue. Rather, Eisen is important to this case because it holds that a petition filed in bad faith necessarily means that any plan is proposed in bad faith. So, when a plan is confirmed, something that can only occur if the plan has been proposed in good faith, it follows that the petition must have been filed in good faith. Whenever a creditor wishes to dispute a debtor's good faith in filing a petition or proposing a plan based on a debtor's preconfirmation conduct, it is incumbent on that creditor to raise the issue before the plan is confirmed, at least when the debtor's preconfirmation conduct has not been concealed. Otherwise, if the assertion of bad faith is not raised prior to confirmation, the confirmation of the plan precludes the creditor from raising the issue.

The movants argue that the holding of the bankruptcy court in In re Powers, 135 B.R. 980 (Bankr. C.D. Cal. 1991), permits dismissal despite the confirmation of the plan. This court disagrees.

Powers is a trial level decision that is not binding on this court. The holdings of the appellate courts in Eisen and in Valenti are binding and they require that this court give effect to its confirmation of the plan by cutting off belated attempts at dismissal that are based on facts known prior to confirmation and that would have prevented confirmation if they had been timely raised.

Also, if Powers can be read to permit a creditor to seek dismissal of a case after confirmation of a plan on the basis of known preconfirmation misconduct, that holding is inconsistent

with Valenti and with many other decisions requiring that motions to dismiss based on a debtor's lack of eligibility for chapter 13 relief be raised prior to confirmation. See, e.g., U.S. v. Edmonston, 99 B.R. 995, 998-99 (E.D. Cal. 1989) (post-confirmation challenge to Chapter 13 eligibility "is precluded by the doctrine of res judicata unless there is a showing of fraud by the debtor.").

Further, implicit in Powers and in the movants' motion is the dubious proposition that a plan may be proposed in good faith even though it is offered in a chapter 13 case that is itself filed in bad faith. If a petition has been filed to gain unfair advantage over creditors, as argued here, to permit confirmation of the plan is to hand a debtor the instrument for realizing his ill-gotten gain. Therefore, as recognized by the Bankruptcy Appellate Panel in Valenti, it is incumbent on creditors to raise their objections to the filing of the petition, as well as the plan, before the plan is confirmed.

In this case, the movants were given notice of the filing of the petition and the proposed plan. During the three months and two weeks between the filing of the petition and the confirmation of the plan, the movants did not challenge the debtors' eligibility for, or motivations for seeking, chapter 13 relief, or object to confirmation of the plan. The plan was confirmed. There is no evidence of any concealment that precluded or impeded the movants in raising objections to the plan or in seasonably moving for dismissal of the petition.

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The motion to dismiss comes too late.[4]

The third response to the motion is that Mr. and Mrs. Gilton had legitimate reasons for seeking chapter 13 relief. Both are 79 years of age, both have been retired for ten years or more, Mr. Gilton's health is declining, neither has ever before filed a bankruptcy petition, and their household subsists on $2,460 a month in social security and pension benefits. After paying Spartan living expenses, they will have a mere $100 a month in disposable income.

The Giltons' debt, $116,163 in secured claims and $155,717 in unsecured claims (not taking into account rejection claims), largely was incurred in connection with an unsuccessful post-retirement attempt to develop a cheese plant. The confirmed plan requires the contribution of their $100 in monthly disposable income for 36 months in order to pay this debt. Because this disposable income obviously will not be sufficient to retire the debt, the plan also requires the debtors to contribute a $3,800 semi-annual rent payment due them as well as the proceeds from

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[4] The court realizes that the movants' motion was filed on September 16, 2005, ten days before the confirmation of the plan on September 26. To be considered as an objection to confirmation of the plan, the motion should have been filed and served on or before August 10. Alternatively, because of the absence of timely objections to confirmation, confirmation was imminent. In this circumstance, the court would have been receptive to an application for an order shortening notice for a hearing on the dismissal motion so that it could be heard before entry of a confirmation order. No such application, however, was made under Local Bankruptcy Rule 9014-1(f)(3). Because this court uses a "self-set" calendar, it is incumbent on a party making a motion and bringing an objection to seasonably set a hearing. See www.caeb.uscourts.gov/data/tentrule/lmS_12_02.pdf (Self-set calendar instructions).

the sale of the property. Section 1322(b)(8) permits a chapter 13 debtor to supplement disposable income in this fashion. See 11 U.S.C. § 1322(b)(8). See also In re Gavia, 24 B.R. 573, 575 (B.A.P. 9th Cir. 1982) ("[W]e construe [section 1322(b)(8)] as permitting a plan to supplement payments from future income.").

Then there is the litigation between the debtors, the movants, and Mr. Trinkler. The income listed on Schedule I suggests that the debtors do not have the ability to fund the litigation. And, given that there are two parties, the movants and Mr. Trinkler, claiming a right to buy the property, giving up and selling the property to the movants will not end the litigation.

The debtors have real financial problems that are capable of resolution in a chapter 13 bankruptcy.

The movants believe that the solution to the debtors' financial problems is to perform, not reject, their executory contract. If the debtors would sell the property to the movants the debtors could fund their plan with sale proceeds and quickly pay their creditors. However, to the extent this was a basis for objecting to the plan, it should have been raised before the plan was confirmed.

The movants' reliance on 11 U.S.C. § 305(a)(1) as well as 11 U.S.C. § 1307(c) does not change the result. Section 305 gives the court the power to abstain from taking jurisdiction over a bankruptcy petition. It is usually invoked when a debtor and the creditors have agreed to an out-of-court workout. Whatever the basis, a dismissal under section 305(a)(1) must be in the interests of both the debtor and the creditors. See e.g., In re

Schur Management Co., Ltd., 323 B.R. 123, 129 (Bankr. S.D.N.Y. 2005). It is not a substitute for a motion under section 1307 or the other dismissal provisions applicable in chapters 7, 11, and 12. Id. The issue of bad faith must be addressed under section 1307(c). Cf. In re Schur Management Co., Ltd., 323 B.R. at 129, n. 5.

This Memorandum Decision supplants the final ruling appended to the minutes of the hearing.[5]

A separate order will be entered.

Dated: 29 Dec 2005

By the Court

Michael S. McManus, Chief Judge
United States Bankruptcy Court

[5] While the court was preparing this Memorandum Decision, the movants filed a notice of appeal and a motion for leave to appeal. The appeal, however, was filed prior to entry of an order disposing of the motion. It is premature. The movants appear to believe that the minutes of the hearing constitute an order denying their motion. The minutes record the appearances at the hearing and append the court's written ruling. The minutes include no order. Because no order had been entered when the notice of appeal was filed, the court issued this Memorandum Decision, supplanting the findings and conclusions in the ruling appended to the minutes, with its order disposing of the motion.

CERTIFICATE OF MAILING

I, Susan C. Cox, in the performance of my duties as a judicial assistant to the Honorable Michael S. McManus, mailed by ordinary mail to each of the parties named below a true copy of the attached document.

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Dated: December 29, 2005

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